

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

RATE ADJUSTMENT DUE TO EXTRAORDINARY OR
EXCEPTIONAL CIRCUMSTANCES

Docket No. R2013-11

**COMMENTS OF THE
NATIONAL POSTAL POLICY COUNCIL,
THE MAJOR MAILERS ASSOCIATION,
THE NATIONAL ASSOCIATION OF PRESORT MAILERS, AND
THE ASSOCIATION FOR MAIL ELECTRONIC ENHANCEMENT
IN OPPOSITION TO EXIGENT RATE INCREASE**

November 26, 2013

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(November 26, 2013)

The National Postal Policy Council (“NPPC”),¹ Major Mailers Association (“MMA”),² National Association of Presort Mailers (“NAPM”),³ and Association for Mail Electronic Enhancement (“AMEE”) ⁴ (collectively “Joint Commenters”) hereby respectfully submit these comments in opposition to the Postal Service’s request for

¹ NPPC is an association of large business mailers, primarily First-Class Automation and Presort Letters, Cards, and Flats, and increasingly Standard Regular letters, with member companies from the telecommunications, banking and financial services, insurance, and mail services industries. Comprised of 36 of the largest customers of the Postal Service with aggregated mailings of nearly 30 billion pieces and pivotal suppliers, NPPC supports a robust postal system as a key to its members’ business success and to the health of the economy generally.

² MAA membership is comprised of companies that serve the communications, utilities, insurance, banking, financial services, healthcare, government and cable/satellite industries. Although there has been diversion to electronic channels, these industries still rely primarily on the USPS for the delivery of the statements, invoices, remittance payments and other business communications.

³ NAPM is a nonprofit organization that represents mailers, both mail owners and mailing service providers who commingle, sort and prepare quality mailings inducted and compliant with work share requirements. Representing over 100 member companies mailing in 36 states, it collectively provides approximately 35% of the total First Class mail volume and over 50% of the Full Service volume. NAPM member mail service provider companies interact with and perform mailing services for tens of thousands of clients and businesses that use postal mailing products.

⁴ AMEE’s member companies represent mailers, associations, and supporting vendors who have a primary interest in increasing the value and utility of First Class Mail and are engaged in developing and/or promoting technology in the area of mail electronic enhancement.

exigent rate increases pursuant to 39 U.S.C. §3622(d)(1)(E).⁵ NPPC, MMA, and NAPM also are sponsoring Comments filed today in conjunction with the Statement of Lawrence G. Buc of SLS Consulting, Inc. ("*Buc Declaration*"), which is being filed concurrently in this proceeding and is supported by a number of companies and associations.⁶

The Joint Commenters are well aware of the Postal Service's financial challenges, and commend postal management for its steps to reduce costs and right-size its operations. However, from the perspective of mailers that themselves have had to adapt quickly to the electronic and mobile world in which customers now live, the Postal Service's problems today do not stem from the recession. Instead, they derive from unrealistic legislative mandates coupled with fundamental demand changes in the market in which it operates.⁷

Mailers themselves are painfully aware of those changes. In particular, the industry that depends upon the postal system has shrunk dramatically in recent years. Collectively, more than 400,000 jobs (not counting those in the Postal Service itself) have been lost in this industry since 2008 as the communications marketplace has changed, and the decline in mailing industry employment since 2001 approaches

⁵ *Renewed Exigent Request of the United States Postal Service In Response To Commission Order No. 1059* at 4 (Sept. 26, 2013).

⁶ *Comments of the National Postal Policy Council, the Major Mailers Association, and the National Associating of Presort Mailers In Connection With The Declaration Of Lawrence G. Buc* (filed Nov. 26, 2013).

⁷ Until recently, operational ("controllable") expenses have trended fairly close to revenues. The Postal Service's balance sheet problems are largely due to several payments it made to prefund retiree health benefits.

1,000,000 jobs.⁸ Unlike the Postal Service, the mailing industry cannot rely upon attrition and incentivized retirements to achieve necessary resizing to actual demand. Since the early 2000s, printing prices have declined by one-third, and paper prices have been fairly static.⁹ Only the Postal Service has steadily raised prices. The combination of continually rising postal rates and sweeping change in the communications marketplace has led to a considerable shrinkage of the mailing industry across all classes. The result from imposing exigent rates is also predictable: it will speed the loss of more mail, and more jobs in the mailing, paper and printing industries.

Accordingly, the Joint Commenters must oppose the requested sharp rate hikes as contrary to the law, improperly driven more by liquidity issues than by an extraordinary or exceptional circumstance, and premised on factually unsupported assumptions about electronic diversion and the recession. Electronic diversion has increased steadily in recent years for reasons entirely independent of the recession, and the Postal Service must adjust to a New Normal just as its customers have. Clinging to a myth that it would have carried 50 billion more pieces had the recession not happened is merely denial. And, since this proposed increase would be counterproductive to the Postal Service's business and revenues, further substantially damage an industry that remains many times the size of the Postal Service, and cause further job losses, the Joint Commenters submit that is not reasonable and equitable and necessary or consistent with sound management and the long-run interests of the Postal Service.¹⁰

⁸ Figures are from the EMA Foundation, 2012 EMA Mailing Industry Job Study.

⁹ See *Buc Declaration* at Figure 4 (chart comparing changes in costs of paper, printing, and postage for the catalog industry since 2001).

¹⁰ The Postal Service at no time has tried what the private sector routinely does when demand for its products and services falls – reduce prices to forestall further losses and to regain market share.

In the alternative, however, if the Commission nonetheless believes some exigent adjustment is justified, these comments also address certain rate level and design issues relevant to First-Class Mail. In particular, the requested exigency prices for First-Class Automation and Presort mail would simply make the Postal Service's financial problems even worse. Rather than further hasten the diversion of the most profitable mail in the postal system to electronic alternatives, the Commission should set prices that encourage profitable First-Class Presort and Automation mail to remain in the mailstream and promote efficient worksharing.

I. THE POSTAL SERVICE'S THEORY OF THE CASE WOULD IMPERMISSIBLY USE THE EXIGENCY PROVISION TO CIRCUMVENT THE PRICE CAP INDEFINITELY

The Postal Service asserts that the problem facing it is, as Mr. Nickerson says, "a lack of adequate liquidity." *Statement of Stephen J. Nickerson* at 5. Indeed, at the November 20 hearing Mr. Nickerson reiterated that the Service's liquidity issue was the "primary consideration" for the exigency filing.¹¹ But a lack of liquidity is not an "extraordinary or exceptional circumstance" under the law which the Commission must apply, because Congress did not intend the exigency provision to be a general cure to the Postal Service's financial problems: "exigent rate adjustments must be causally linked to the net adverse financial impact of the exigent circumstances rather than the amount of revenue lost." Order No. 864 at 45; *see also* Order No. 547 at 60-61..

To link its liquidity problems to an event that might satisfy the law, the Postal Service asserts that the recession caused "a continuing loss of annual volume, revenue

¹¹ This is not new. In the 2010 exigency case, the Commission observed: "The overall impression is that the Postal Service filing is not driven by its claimed exigent event, but rather a desire to address its existing financial condition." Order No. 547 at 68. The same holds true in this case.

and contribution.” *Nickerson Statement* at 4. It asserts further that those volume losses have *continued to increase* in the years since – despite more than four years of continuous economic recovery – so much that FY2012 volumes were *53.5 billion pieces less* than they would have been if not for the recession. *Further Statement of Thomas E. Thress*, Table One & 7; *Response to Presiding Officer Information Request No. 6*, Q16 (Nickerson).

As discussed in more detail below, this breathtaking contention rests upon unsupported assumptions regarding mailer behavior and electronic diversion buried in the Postal Service’s demand model. It also reflects a failure to adjust to the Postal Service’s reduced role in the New Normal that has emerged from the changes sweeping the communications marketplace, as well as a sense that the Postal Service somehow is entitled to credit for essentially every piece of mail that it handled in 2006 as if the broadband and mobile revolutions had not occurred.

As this Commission recognized previously, Congress did not enact Section 3622(d)(1)(E) “to provide an all purpose exception to the price cap.” Order No. 547 at 64. Nor did it create a piggybank to sustain the Service as it continues to lose volume to electronic alternatives and struggles to adapt to the modern communications era. As the leading Senate sponsor of the Postal Accountability and Enhancements Act of 2006 noted in a recent letter to this Commission, allowing above-cap rate increases due to “extraordinary or exceptional circumstances” was intended to be used rarely. *Letter from Sen. Susan M. Collins to Ms. Shoshana Grove* at 1 (October 18, 2013). Referring to the technological changes in the communications industry over the last decade, Sen. Collins stated that “Electronic diversion of mail has been a foreseeable and an ongoing

problem for the Postal Service” for many years” and that the exigency provision was not intended to “be used to recoup revenue lost as a result of electronic diversion and similar long-term trends.” *Id.* at 2.¹²

Moreover, the Postal Service’s position in this proceeding would in practice repeal the statutory price cap governing prices of market-dominant services, which the Commission has acknowledged is “the cornerstone of the modern system of ratemaking under the PAEA.” Order No. 864 at 33. It would do so in two ways. One, the Postal Service asserts that it could recover up to \$6.65 billion in “losses” for FY2012 alone, but seeks only a portion of that amount now, leaving open the possibility that it could return with a future exigency case to recoup more of its alleged losses, a possibility that the Postal Service has not foreclosed despite several opportunities to do so.

Two, by contending that the recession’s effects (now more than four years after it ended) are continuing (and worsening),¹³ the Postal Service is setting up a process that could allow it to file annually for exigent increases, each allegedly “due to” the recession, indefinitely for years to come. That this is not far-fetched is evident from its recent claim, using its same methodology, that the recession has cost it 58.789 billion pieces in FY2013, and will cost it another 63.894 billion pieces in FY2014. *Response to POIR No. 6*, Q14 (Thress). If the Commission approves the Postal Service’s approach

¹² Indeed, the legislative history indicates that not even the retiree health benefit prefunding obligation would justify an exigent rate increase. Earlier versions of the bill that became the PAEA would have allowed adjustments because of “any new and significant statutorily imposed funding obligations not fully funded through appropriations.” See 106TH CONG., 1ST SESS., H.R. 22, Section 3733(f). Rep. John McHugh, the principal drafter of H.R. 22, deleted the “statutorily imposed funding obligations” clause from his bill in the 107th and later Congresses. The removal of that language from the legislative texts under consideration is an indication that Congress did not intend for the exigency provision to provide a means of recouping the costs of the prefunding requirement.

¹³ See *Response to Presiding Officer Information Request No. 1*, Q4(c) (Thress) (stating “I have seen no evidence that negative trends in mail volumes which have resulted from the Great Recession are abating”).

to calculating lost revenues, then the exigency clause will impermissibly “swallow the rule.” Order No. 864 at 36. And, indeed, the Postal Service may seek to do just that, as it has refused to say that it would not come back to the well again in the future. See *Response of the United States Postal Service to Presiding Officer’s Information Request No. 5*, Q2 (b) & (c) (merely disclaiming “any present intention” to do so). And Mr. Nickerson said nothing in the November 20 hearing inconsistent with that.

The exigency provision was never intended to enable the Postal Service to circumvent the cap indefinitely and, in effect, return to the days of cost-of-service regulation but with far fewer procedural protections for mailers. The Commission should not enable that outcome.

In this case, the Postal Service is playing up the “Great Recession” as the cause of most of its volume losses, because without that purported causation it is simply asking for money just as it did in Docket No. R2010-4. Of course, the Postal Service has a tactical reason in this proceeding for blaming its volume declines on the recession instead of on normal economic cycles or electronic diversion, or attributing them to diversion and other fundamental market changes, as it has elsewhere.¹⁴

As shown in the Section II, however, its attempt to show that the recession caused the bulk of its volume losses is unpersuasive. The Joint Commenters submit that the Postal Service must recognize that electronic diversion – not “competition” *per se* – has greatly changed mailers’ demand for postal services. There is a “new normal,”

¹⁴ See *United States Postal Service, “Ensuring a Viable Postal Service for America: An Action Plan for the Future,”* at 4 (Mar. 10, 2010) (stating that the “primary cause [of the volume decline] is a fundamental and permanent change in mail use by households and businesses. Hardcopy communication of all types continues to shift to digital alternatives. More people are paying bills and transacting business online.” *United States Postal Service, “Plan To Profitability,”* at 9 (February 16, 2012) (stating “Diversion of communication and commerce to electronic channels is a principal contributor to declining First-Class Mail volumes”).

but it is not “due to” the recession. Accordingly, a proper understanding of the winds currently swirling around the Postal Service must lead to a rejection of the request for exigent price increases.

II. THE POSTAL SERVICE HAS NOT MET ITS BURDEN OF DEMONSTRATING THE VOLUME LOSSES “DUE TO” THE RECESSION THAT COULD JUSTIFY THE REQUESTED EXIGENT RATES TODAY

In Docket No. R2010-4, a majority of the Commission concluded that the recession that ran from December 2007 to June 30, 2009, was an “extraordinary or exceptional circumstance” within the meaning of Section 3622(d)(1)(E). Order No. 547 at 53, *remanded on other grounds, United States Postal Service v. Postal Regulatory Commission*, 640 F.3d 1263 (D.C. Cir. 2011).¹⁵ The Postal Service cites that now three-year-old ruling as the predicate exigent circumstance.

The Commission’s finding in Order No. 547 does not support the nearly \$3 billion rate increase above CPI demanded by the Postal Service in this case. In particular, the Postal Service’s showing is defective because:

- It has not limited its claims to volume losses that occurred during the recession, but rather bases its claims on volumes allegedly “lost” during the third year of the economic recovery;
- It relies exclusively upon an econometric demand estimation model – which itself has required frequent tinkering – and which depends upon unreasonable assumptions “outside of the model” about the rate of electronic diversion in recent years that conflict with the experience of actual mailers;

¹⁵ A unanimous Commission proceeded to determine, however, that the substantially above-cap increases requested by the Postal Service in that case were not “due to” the recession, but rather were (as here) an attempt to address the Postal Service’s broader financial challenges. Order No. 547 at 63-68. On judicial review, the Court of Appeals agreed with the Commission that the amount of the increases sought under Section 3622(d) must be causally related to the asserted “extraordinary or exceptional” circumstance, remanding the case for elaboration on the causal nexus.

- The Postal Service's own delays have so worsened the situation – under the Postal Service's own theory of the case – that the equitable doctrine of laches should bar any higher rates based on FY2012 volumes.

Accordingly, the Commission should reject the request.

A. The Postal Service Bears The Burden Of Proving The Losses Attributable To The “Extraordinary Or Exceptional” Circumstances

The Postal Service has the burden of proving “the net adverse financial impact of the exigent circumstances.” Order No. 864, at 46 (emphasis supplied) & 39 C.F.R. §3010.61(a). Assigning the burden of proof to the Postal Service is appropriate, because it is the entity that seeks several billion dollars in additional revenue and contribution, it controls the operational and financial data and the timing of the request, and doing so is fully consistent with the legislative history, which the Commission reviewed in Order No. 547.

The Commission has also stated: “the quantification offered by the Postal Service to support an exigent request must be justified through supportable methods commensurate with the amount of the proposed adjustment. Vague generalizations and unsupported conclusory statements are not sufficient.” Order No. 864 at 49-50. that the evidence needed “will vary in degree depending on the nature of the exigent circumstances, the amount of the proposed adjustment, and the complexity of the exigent request,” and must be “commensurate with the amount of the proposed adjustment.” *Id.* at 49-50. A “larger amount,” such as is sought here, “requires more rigorous estimation techniques and a more persuasive showing that the sums sought are the result of the exigent circumstances.” *Id.* at 50. A requested multi-billion dollar rate increase demands a compelling showing.

The Postal Service attempts to do so here through the use of its demand model and Mr. Nickerson's calculation of net lost contribution from the volumes allegedly "lost" due to the recession. This effort fails to meet the Postal Service's burden of proving the amount of lost net contribution from the 2007-2009 recession for the reasons discussed in the following sections.

B. The Postal Service Erroneously Seeks To Recover Volume Lost Not During The Recession, But During The Recovery

In Order No. 864, the Commission held that:

exigent rate adjustments must be causally linked to the net adverse financial impact of the exigent circumstances rather than the amount of revenue lost. Given the exigent circumstances found to have occurred in this case, the net adverse financial impact would consist of the lost contribution associated with the volume declines *from the 2008-2009 recession*.

Order No. 864 at 45 (emphasis supplied). Upon reading this directive, one reasonably would have expected the Postal Service to try to show what volumes it lost in 2008-2009 due to the recession. But it has not done so in this case.¹⁶

Instead, the Postal Service bases its claim for volume and net revenue loss on alleged lost volumes in 2012. *See Further Statement of Thomas E. Thress*, Table One (Sept. 26, 2013); *see also* Library Reference USPS-R2010-4R/10; *Response to POIR No. 6*, Q16. As the Commission recognized in Order No. 547, the recession ended in FY2009:

According to the National Bureau of Economics, the recession officially began in December 2007 which corresponds to the end of the first quarter of Postal Service

¹⁶ In contrast, it did attempt to do so in its filings in Docket No. R2010-4R on November 21, 2011, but those filings were never reviewed and the Postal Service apparently has abandoned them.

FY 2008, and ended in June 2009, at the close of FY 2009 quarter 3. Inclusion of any volume loss prior to the beginning of the recession, or experienced after the close of the recession in an analysis of the impact of the extraordinary or exceptional circumstance would appear to be problematic.

Order No. 547 at 79. The year 2012 was not a year in which the economy was in recession, but rather was the third consecutive year of economic *growth* in the United States.

The Postal Service addressed this passage briefly in its *Renewed Request*, stating that “it was plain to anyone who lived through the recession that its effects did not instantaneously disappear in July 2009.” *Id.* at 11. However, it proceeded to say that the issue may not need resolution because of the “modest nature of the proposed increases.” *Id.* It labels the requested \$1.78 billion in net contribution it seeks through the rates in this case as “modest” because it claims a total loss of \$3.642 billion in net contribution in FY2012 *Id.*

The Postal Service is too dismissive of this issue. Mailers certainly do not regard a requested increase that is triple the rate of inflation (on top of an inflation adjustment already approved), to achieve a net contribution of \$1.78 billion, as “modest.” Coupled with the index adjustment recently approved in Docket No. R2013-10, the increases would amount to 6 percent, the largest rate increase since the PAEA was enacted. In addition, the increase would remain in the rate base permanently, as the Postal Service has shown no inclination to rescind it in the future.¹⁷

¹⁷ This is not an idle risk. Mailers continue to pay the \$3.1 billion annually added to the rate base in Docket No. R2005-1 to fund the former escrow obligation. The total amount paid by mailers for this now exceeds \$21 billion.

If the relevant volume losses were limited to those during the recession years (instead of during Fiscal Years 2010 through 2012, in which the economy was growing), the alleged volume loss falls by more than a third, to 34.759 billion pieces under the Postal Service's own analysis.¹⁸ *Thress Further Statement*, Table One, Column 2008-2009).¹⁹ That alone would reduce the allegedly lost "net contribution" correspondingly, leaving much less margin for error in accuracy of the Postal Service's demand model's estimate of volume losses caused by the recession. And, as shown below, even that smaller number improperly includes volumes that were lost to electronic diversion independently of the recession, and which cannot be said to have been "due to" the recession at all.

C. The Postal Service Demand Model Depends Upon Assumptions About The Rate Of Electronic Diversion That Are Inconsistent With Its Own Modeling Difficulties, Unreasonable, And Contrary To Mailer Experience

When seeking an exigent rate increase, the Postal Service "must factor out the financial impact of non-exigent circumstances, such as the continuing effects of electronic diversion." Order No. 864 at 48. Doing so "ensures that an exigent rate adjustment is limited to the adverse effects of the exigent circumstances as opposed to other, non-exigent factors." *Id.* Here, the Postal Service has chosen to rely solely upon

¹⁸ The Postal Service rests its case on its econometric demand models. Econometrics is part art and part science. The Joint Commenters do not concede that the Postal Service's models are inevitable or necessarily accurate, especially given the need for Intervention analysis. It is conceivable that a different econometrician, looking at the matter afresh, might develop a much different model.

¹⁹ This is imprecise. The recession actually included one quarter of FY2007 and only three quarters of FY2009, rather than the complete 2007 and 2008 fiscal years. However, the number from Mr. Thress's Table One does include the correct number of quarters.

its demand estimation model, presented in the Further Statement of Thomas E. Thress, to meet its burden of showing what volume losses were “due to” the recession.

While the Commission did contemplate that the Postal Service might use such a method to help quantify the net adverse impact of a recession (Order No. 864 at 50), that does not relieve the Postal Service of the duty of proving its case, or excuse it from making unreliable assumptions in its model. In particular, the Postal Service has made two critical assumptions that, upon examination, appear unreasonable. Without those assumptions, its case falls apart.

The analysis presented in the Thress Further Statement is “a backward-looking analysis of the factors which affected mail volumes over the historical time period from FY 2008 through FY 2012”). *Response to POIR No. 5, Q5(c)* (institutional). In preparing the analysis, the Postal Service assumed that the trends in its model that existed in 2008 continued through 2012. *Response to POIR No. 2, Q8* (Thress) (stating “Historical trends are projected to continue forward at the same rate because I have no reason to assume that they will not”).²⁰ And, of particular interest to the Joint Commenters, when modeling the known volumes from 2008 to 2012 in hindsight, the Postal Service assumed that the rate of electronic diversion would “remain constant in the absence of evidence to the contrary.” *Response to POIR No. 6, Q25(a)* (Thress) (bold in original).²¹ That was the first critical assumption, standard in econometric modeling but requiring reexamination in every case.

²⁰ In fact, the Postal Service assumed that the recession caused all mail losses beyond pre-existing trends unless it was otherwise disproved. *Response to POIR No. 6, Q4* (Thress).

²¹ This assumption is consistent with how the Postal Service’s normal practice: “Historical trends are simply projected to continue forward at the same rate.” *Narrative Explanation of Econometric Demand Equations for Market Dominant Products Filed with Postal Regulatory Commission on January 22, 2013* at 16 (July 1, 2013).

Furthermore, to account for observed volume losses not accounted for by the explanatory factors so that the model can replicate observed volumes, the Postal Service in this case added Intervention analysis (in the form of time trends) to its demand equations. *Response to POIR No. 6, Q12 (Thress)* (“mail diversion is modeled via Intervention trends”); *Response to POIR No. 6, Q25 (Thress)* (diversion trends explain all trends in mail volumes not otherwise accounted for, whether due to electronic diversion or other factors). The Postal Service then assumed that to the extent these “trends” showed a faster rate of diversion than the rate it observed in 2008, such increased diversion was “due to” the recession (and thus, under the Postal Service’s theory, the corresponding financial losses are recoverable through exigent rates). *Response to POIR No. 1, Q4(c) (Thress)*.²²

This is the second critical assumption, one not standard in econometrics, but a judgmental one which the Postal Service must justify. This assumption is not calculated by the econometric demand model, but is a judgment made by Mr. Thress. Intervention analyses are not tools for teasing out causation: “to identify the specific factors underlying net mail diversion, it is necessary to step outside of the econometric model and seek outside information on what these factors might be and their relative importance.” *Response to POIR No. 6, Q25(b) (Thress)*; accord *Response to POIR No. 3, Q1 (Thress)* (stating that to understand why net diversion trends have changed “requires moving outside of the econometric models and analyzing the underlying factors that are driving these trends”); *Response to POIR No. 6, Q4(b)&(c)*. Put

²² *Response to POIR No. 3, Q1 (Thress)* (stating “I believe the recession increased electronic diversion because the steep decline in the economy created much stronger incentives for consumers, business and governments to find less costly ways to engage in communication and conduct financial transactions”).

differently, because the Intervention trend does not imply causation, whether that increased diversion is caused by the economy, technology, or other factors is a matter of an assumption made “outside of the model.”²³

Together, these assumptions mean that the Postal Service has assumed that the rate of electronic diversion *continued unchanged for at least five years* but for the recession. Thus, they provide the crucial cornerstones of the Postal Service’s contention that the recession was by far the greatest factor in the volume declines, dwarfing electronic diversion. See LR-USPS-R2010-4R-10, Exigent Impacts.xls.; *Response to POIR No. 3, Q5* (Thress).

The Joint Commenters submit that both assumptions are incorrect:

- First, the assumption that it has modeled diversion accurately over a five-year period ignores its long history of problems in modeling diversion and the frequent changes in its models;
- Second, the assumption that all changes in the pace of electronic diversion during the recession and thereafter are “due to” the recession conflicts with the massive changes in technology that occurred in recent years, starting with the iPhone, wireless broadband, broadband-dependent services such as YouTube, and consumers’ growing comfort with using broadband technology for an increasing number of purposes, which have contributed to the resulting New Normal.
- Third, the assumption that electronic diversion would not have increased but for the recession is contrary to mailers’ experience.

Assuming that “historical trends are simply projected to continue forward at the same rate” and that increased diversion is due to the recession beg the central question in this case. Given these assumptions, the Postal Service’s conclusion that any acceleration

²³ As Mr. Thress said during the November 19 hearing, the Postal Service cannot ascribe causation to an Intervention analysis trend because the numbers in a trend factor do not know *why* volume is changing.

of electronic diversion since the recession must have been caused by the recession and not by other factors was preordained.

In addition, the Postal Service's assumptions also impermissibly shifted the burden of proof. When asked why he judgmentally attributed certain factors, including greater electronic diversion, to the recession, Mr. Thress stated: "I could not find sufficient evidence to support the possibility that these factors were caused by something other than the Great Recession." *POIR 2*, Q8. In other words, that the recession caused greater diversion was assumed *unless* it was disproven. Order No. 864 requires the contrary.

Furthermore, the Postal Service's assumptions conflict with its own experience, are implausible, and are contrary to mailer experience. Accordingly, the Commission should find that the Postal Service has failed to establish what losses it has suffered "due to" the recession of 2007-2008.

1. The Postal Service's assumption that electronic diversion would have been constant during the recession and thereafter conflicts with its own demand modeling experience

The Postal Service's assumption that the rate of electronic diversion prior to the 2007-2008 recession continued unchanged during the recession and several years of economic growth thereafter, while perhaps a standard starting point in economic modeling, is a rather unlikely assumption. This is because the Postal Service's past experience with modeling diversion should not give anyone much confidence in its accuracy over even a short period, much less five years.

The Postal Service has struggled for years to find an accurate way to model electronic diversion, trying various different approaches. It has found it necessary to

tinker constantly with its methodology, often annually, in an effort to reproduce the actual diversion seen, which it then uses to project forward.²⁴ Each time, it has eventually concluded that the approach it was using needed to be changed. *E.g.*, *Response to POIR No. 3*, Q1 (Thress) (“Internet usage variables are no longer adequate for capturing growing diversion of the mail to the Internet and other electronic alternatives”); *Response to POIR No. 4*, Q2 & Q6 (Thress) (conceding that former Internet variables fail to explain diversion); *Response to POIR No. 6*, Q12(c) (Thress). In light of this experience, the Postal Service’s assumption that the rate of electronic diversion did not change for the past six years is unreasonable on its face.

In fact, although the Postal Service’s demand model broadly follows the same general approach as in years past, the specific model used in this proceeding differs in a number of respects and has never been reviewed by (or even filed with) the Commission.²⁵ The model filed in this case differs in several respects from the version that the Postal Service filed in January 2013. *Response to POIR No. 4*, Q9. It also differs in many details from that filed in Docket No. R2010-4. *Response to POIR No. 6*, Q12(b) (Thress)

For many years, the Postal Service modeled electronic diversion by including measures of Internet consumption (*e.g.*, broadband subscriber penetration, Internet Services Providers consumption) as factors in its equations. In time, the Postal Service

²⁴ These changes are evident from the Postal Service’s routine annual January filings of its volume forecasting methodology, and from the explanatory material it files each July.

²⁵ The last time the Postal Service’s volume methodology was subject to Commission analysis was in Docket No. R2006-1. The last time that it underwent adversarial scrutiny was in Docket No. R2010-4. NPPC challenged certain aspects of the version of the volume forecasting model that the Postal Service offered in that docket, but the Commission never addressed that issue in that proceeding.

abandoned that approach as unfruitful²⁶ and adopted “a more direct methodology which forecasts Internet multipliers explicitly.”²⁷ The new approach treated Internet variables as a function of a linear time trend of the Postal Service’s own estimates of diversion over the past six years.²⁸ In the case of First-Class workshared mail, this cumulative net trend process attributed nearly 17 percent of the volume loss over the then-preceding five years to Internet diversion. *Id.* at 36.

This practice of forecasting Internet diversion through this “set of simple multipliers” derived from the econometric demand equations was short-lived. The Postal Service’s demand models filed in January 2012 abandoned the “Internet” variable in First-Class Single Piece, replacing it with three different time trends.²⁹ Because the Internet usage variables did “not properly capture recent rates of diversion,” it replaced the Internet variable in First-Class workshared mail with two time trends.³⁰ *Response to POIR No. 4*, Q6(c) (Thress). Indeed, the Postal Service has conceded that the Internet usage variables that it relied upon in Docket No. R2010-4 became unable to account for the observed rates of mail diversion. *Response to POIR No. 6*, Q12 (Thress).

²⁶ *Econometric Demand Equations for Market Dominant Products as of January, 2010* at 17 (filed July 1, 2010).

²⁷ *Id.* at 17-18.

²⁸ *Id.* at 18. That procedure used an unweighted linear trend of the Postal Service’s own estimates of Internet diversion in each of the past six annual forecasts. The Postal Service did not consider forward-looking projections of electronic diversion in preparing these forecasts.

²⁹ *Changes to Econometric Demand Equations for Market Dominant Products since January, 2011* at 3 (filed July 1, 2012).

³⁰ *Id.*

By the time it filed its demand equations on January 22, 2013, the Postal Service had already found it necessary to adjust its use of linear time trends. Still further changes were made in the filing for this case. See *Response to POIR 4*, Q7 (Thress); *Response to POIR No. 6*, Q12 (Thress). In Standard Regular mail, the Postal Service found it necessary to include for the first time a new dummy variable beginning in 2012Q2 to account for “significant unexplained declines in Standard Regular mail volume in FY2012.”³¹ That negative variable accounted for more than 12 percent of the volume loss shown in that model. Curiously, the Postal Service simultaneously assumed that there was no change in the effect of electronic diversion on Standard Mail Regular volume.³² Isn't it at least possible that electronic diversion could have accounted for some or all of that otherwise unexplained 12 percent reduction?³³

Put simply, the Postal Service has had great difficulty in modeling electronic diversion. In view of the frequent changes it has made, one could reasonably conclude that the Service has yet to identify a reliable electronic diversion factor. Given its past ineffectiveness in modeling diversion, the Postal Service's assumption that electronic diversion would remain unchanged during the recession is unreasonable.

2. The assumption that all increases in electronic diversion since 2007 was caused by the recession lacks supporting evidence and is implausible

The Postal Service does not dispute the electronic diversion increased during the recession. It simply assumes that all of the increase embedded in its Intervention

³¹ *Id.* at 44.

³² *Thress Further Statement.*, Table Two.

³³ Indeed, Mr. Thress rejected the possibility that an improved ability of advertisers to use the Internet could account for this reduction. *Response to POIR No. 3*, Q9.

trends was “due to” the recession. *Response to POIR No. 3, Q1* (Thress). That assumption is contrary both to the effect on consumers of the rapid technological transformation of the communications marketplace during 2007 to 2012 and the experience of mailers.

For example, consider a few of the technological developments in the communications marketplace since the volume forecasting methodology and was last subject to adversarial scrutiny and Commission analysis in 2006:³⁴

- The iPhone was introduced on January 9, 2007.
- Smartphones capable of wireless broadband communications have since spread like kudzu around the world, as have the networks on which they operate. Nearly one billion smartphones are projected to be sold worldwide in 2013; more than 140 million people in the United States currently own and use a smartphone.
- The iPad was announced on Jan. 29, 2010, and made available on April 3, 2010. Since then, sales of broadband-capable tablet devices have easily exceeded one hundred million, both large and mini sizes, have been sold.
- The Facebook website opened to anyone over 13 years of age on September 11, 2006, and has over one billion users.
- The Twitter website was launched in July 2006. In 2007, 400,000 tweets were posted per quarter. By 2008, 100 million tweets were posted per quarter. By February 2010, 50 million tweets were being sent on an average day. And in March of 2013, that number was up to 400 million per day.
- Gmail became available to the general public on February 7, 2007.
- Google+, which now claims to be the second-largest social networking site, having more users than Twitter, launched on an “invitation only” basis on June 28, 2011.

³⁴ In Docket No. R2010-4, NPPC offered several criticisms of the Postal Service’s volume forecasting methodology, noting that the Postal Service had underestimated the volume loss in Presort mail that would result from the exigent rates requested in that proceeding. The Postal Service responded to NPPC’s critique. However, the Commission decided that case on other grounds and never addressed NPPC’s criticisms of the Postal Service’s forecasting methodology.

- Computer hardware and software became even lower cost, especially database marketing software.
- Texting and mobile applications have reached levels of usage unanticipated by anyone in 2007, and the latter did not exist in any meaningful sense until the iPhone was invented.
- Large segments of the population, known colloquially as Generations X, Y, and the Millennials, are digital natives who rely primarily on electronics to communicate rather than paper.
- The United States government has increasingly been striving to place transactions and information online (and, indeed, the Postal Service is designing and will be administering a portal for the entire federal government).

All of these factors have helped to create what the hearing referred to as the “New Normal.”

In addition, regulatory changes at the federal and state levels increasingly are allowing businesses to deliver more legally-required notices and records electronically. For example, eleven states now allow online presentment of insurance policy contracts, and twenty-six allow mobile presentment of insurance cards. Four allow the sending of a cancellation notice by email. Previously, all of these communications were by law required to be sent by mail. *See Buc Declaration* at 18-19.

These developments cast serious doubt on the reasonableness of the Postal Service’s assumptions regarding unchanged rates of electronic diversion. The Postal Service simply hopes that the effects of all of these developments are included in its electronic diversion factor – which in the current iteration of the model means that the myriad effects of these developments must all be encompassed in an Intervention Analysis. *Response to POIR No. 4, Q2 (Thress)* (“smartphones are a new way to access the Internet” and technological and social changes since 2004 are

“continuations of existing trends”).³⁵ Putting aside the fact that the Postal Service does not know what is causing the Intervention trends to occur (*Response to POIR No. 6, Q25(b) (Thress)*), there is no self-evident reason to think that this is in fact so. But every one of these technological innovations in the communications market affects mailers’ choices as to how to communicate messages to their friends and existing and potential customers.

As broadband penetration has deepened – both wired and wireless – consumers and businesses have become far more comfortable with using it for ordinary transactions, many of which would have used mail in the past. Anyone who has seen birthday greetings or engagement announcements via Facebook, or who has received electronic bill presentments and made payments online, or who has received electronic confirmations of financial transactions, or watched streaming videos (preceding by 30 second ads) on broadband wireless devices knows that consumers have grown increasingly comfortable with contemporary Internet devices, and are using them in ever more dealings with businesses and in data-intensive ways.

In light of these developments, Mr. Thress’s speculation to the opposite, that “the rate of growth in Internet usage by Americans is attenuating,” seems improbable, to say the least. *Response to POIR No. 3, Q1; accord* (it “could conceivably be the case” that Internet diversion of mail volumes has attenuated as Internet usage nears full market penetration”). It is more reasonable to assume that as Internet and, especially, broadband penetration has expanded, and as the proportion of the population

³⁵ The Postal Service’s view that “technology innovation” is an insufficient explanation for recent negative mail volume trends (*Response to POIR No. 4, Q6 [Thress]*) is merely indicates the adequacy of how it has modeled electronic diversion.

consisting of Millennials and digital natives increases,³⁶ consumers have become more comfortable with using those devices more often and in more ways. While the *rate* of *broadband* adoption (the Joint Commenters are unclear whether this refers to wireline only or may include wireless broadband) may or may not be waning as penetration increases,³⁷ the ways in which it is *used* seems to be deepening and expanding rapidly.

Consider also that the Postal Service model assumes that electronic diversion had no measurable effect on Standard Regular mail volumes during the recession or thereafter. See *Thress Further Statement* at 8, Table Two. That means that the Postal Service believes that essentially no advertising has diverted from Standard Regular Mail to alternatives such as Google search results, Website display advertising or behavioral targeting, advertising in mobile applications, or other options. This assumption seems implausible at best. For example, Internet advertising revenues recently were estimated to have exceeded \$20 billion in the first half of 2013, an 18 percent year over year increase.³⁸ The Postal Service assumption that none of those advertising revenues was diverted from Standard Regular seems unlikely.

³⁶ The Postal Service Inspector General recently issued a research paper on how to enhance mail for Digital Natives. It noted that the “decline in transactional mail, like bills and personal correspondence, primarily due to online alternatives, has driven a decline in First Class Mail that is expected to continue into the foreseeable future.” Office of Inspector General, *Enhancing Mail for Digital Natives* at 1 (Nov. 18, 2013).

³⁷ At least one recent estimate projects smartphone penetration in the United States will rise from today’s roughly 140 million to nearly 245 million by 2020. <http://www.asymco.com/2013/10/08/how-many-smartphone-users-will-there-be-in-the-us/>. Another estimate, from April 2012, projected that there would be 192 million by 2016. <http://zboostyourlife.wi-exblog.com/2012/04/12/emarketer-com-majority-of-mobile-users-will-have-a-smartphone-by-2013/>.

³⁸ “Internet Ad Revenues At \$20.1 Billion Hit Historic High For Half-Year 2013, Up 18% Over Same Time In 2012,” Interactive Advertising Bureau (October 9, 2013).

3. The Postal Service's assumptions regarding electronic diversion are contrary to the experience of mailers

The best way to develop an understanding of what may “cause” volume changes is to survey mailers to find out how and why they make mailing decisions. The Postal Service knows this; indeed, it has done so in the past when trying to understand why volumes might be changing.³⁹

But in this case, when proving volume losses were “due to” the recession is essential, the Postal Service made no effort to do so. No mailer surveys, focus groups, or interviews appear anywhere in the Postal Service's documentation of its demand model, steps that might have been fruitful in determining what factors *caused* volumes to drop over the past five years to the New Normal (rather than merely might have coincided with volume declines). The Postal Service has based its entire “proof” of the degree to which the recession caused volume losses on an econometric exercise informed in crucial respects by “judgment” entirely devoid of any input from actual mailers regarding how they made, and continue to make, decisions about mailing.

The Postal Service tried to distinguish the prior occasions in which it surveyed mailers, arguing that there is no disconnect between “identifying the key driver of mail volume away from the Postal Service over the past five years as the Great Recession while simultaneously identifying the key driver of mail volumes away from the Postal Service over the next ten years as diversion of mail to electronic alternatives.”

Response to POIR No. 5, Q5(c). This is unpersuasive. First, the years 2010 to 2012

³⁹ See Boston Consulting Group, *Projecting U.S. Mail Volumes to 2020* (Mar. 2, 2010) (conducted over 50 “deep interviews” with largest mailers to identify what will affect mail usage over next decade); United States Postal Service, “*Ensuring a Viable Postal Service for America: An Action Plan for the Future*” (July 21, 2010); Office of Inspector General, United States Postal Service, *Summary of Focus Group Discussions on the Future of First-Class Mail* (April 20, 2012) (focus groups with high-volume First-Class Mailers to evaluate current and future states of First-Class Mail).

were the subject of both the BCG study and the demand model used in this case. The former might have provided useful input into the latter. Second, the Postal Service again is assuming the result; assuming that the recession caused the diversion instead of finding out from mailers what drives their mailing decisions.

To fill the gap, the Joint Commenters, with the support of a number of other mailing entities, commissioned SLS Consulting, Inc. (“SLS”) to survey and interview mailers to understand how they use electronic diversion, and how the recession affected that usage. See *Buc Declaration* at 3-4 & 10-25. Most significantly, the SLS surveys and interviews “provide no support for the proposition that the recession in and of itself caused increased diversion. In fact, they point to just the opposite conclusion: increased diversion was independent of the recession.” *Buc Declaration* at 4.

Contrary to the Postal Service’s assumptions, electronic diversion was increasing in the late 2000’s for many reasons. Importantly, consumers have become increasingly comfortable with electronic communications and engaging in transactions with business online or via mobile devices.⁴⁰ The more important factors driving electronic diversion were:

factors that relate to technology availability
(Introduction/adoption of new technologies by customers,
Development of electronic alternatives by companies), the
acceptability to customers of new technology (Increased
comfort level of customers with electronic alternatives, The
Growing number of “digital natives”), and company
understanding that e-communication is a less expensive
alternative than paper.

⁴⁰ In 2010, Boston Consulting Group advised the Postal Service that: “Mobile will emerge as a key platform in the next decade – and one that also eliminates mail. Banks see consumer appetite for instant statements of account balances, and they are testing mobile solutions now.” Boston Consulting Group, Inc., *Projecting U.S. Mail Volumes to 2020* at 9 (Mar. 2, 2010).

Buc Declaration at 23. In contrast, most of the respondents ranked the recession as the *least* important factor for shifting more communications to the Internet, and their budgetary practices during the late 2000's are consistent with that ranking. *Id.* at 23-25.

To answer the question of why electronic diversion changes requires consulting with actual mailers. That the Postal Service's entire case rests upon a methodology uninfluenced by any on-the-ground research involving actual mailers should undermine its credibility.

D. The Postal Service Should Be Barred From Obtaining Exigent Rates Under The Doctrine Of Laches

In this case, the Postal Service is alleging ever-increasing "lost volumes" in each and every year through FY2012. By waiting until September 2013 to file its "Renewed Request," the Postal Service has made matters worse, by its own analysis. In the meantime, mailers have relied to their detriment on the Postal Service's not having filed a request for exigent rates. Accordingly, the Joint Commenters submit that the Postal Service is barred by the doctrine of laches from basing any request for exigent rates on FY 2012 data, or from any subsequent period.

It is important to note that the responsibility for the delay resides entirely with the Postal Service. It was the party that sought judicial review of the Commission's September 30, 2010, decision, instead of resubmitting its case in conformity with Order No. 547. As a result, nearly a full year passed before proceedings resumed at the Commission when, on September 20, 2011, the Commission responded to the Court of

Appeals' directive that it further explain the requisite "due to" relationship between the exigent circumstance and the amount of revenue that it can raise.⁴¹

Although at that time more than one year had already passed since the Postal Service first asserted that exigent increases were urgently necessary, the Postal Service delayed action two additional years. In total, the Postal Service has allowed more than three years to pass since it first contended that an exigency existed.

Indeed, the Postal Service responded to Order No. 864 by moving to *stay* further proceedings pending the progress of postal reform legislation.⁴² The Commission denied that request, noting that delay would "prolong uncertainty and contravene the statutory objective of 'creat[ing] predictability and stability in rates.'⁴³ It directed the Postal Service, if it wished to pursue its request, to file by November 7, 2011, an explanation of how the record as it stood satisfied the causal "due to" nexus or requesting leave to supplement the record.

On that day, the Postal Service informed the Commission that it wished to pursue the case.⁴⁴ Two weeks later, it filed statements of two witnesses, but failed to provide all of the information required by Part 3010 of the Commission's rules. The Commission

⁴¹ See *Order Resolving Issues on Remand, Rate Adjustment Due To Extraordinary or Exceptional Circumstances*, Docket No. R2010-4R at 8 (Sept. 20, 2011) (Order No. 864).

⁴² *Motion of the United States Postal Service To Stay Its Request for Exigent Relief* (Oct. 4, 2011).

⁴³ *Order Denying Motion To Stay and Establishing Further Procedures* (Oct. 31, 2011) (Order No. 937).

⁴⁴ *Statement of the United States Postal Service Regarding Its Exigent Request* (Nov. 7, 2011).

allowed the Postal Service to “submit additional materials as required by Commission rules to complete its Exigent Request.”⁴⁵

Despite the alleged urgency of the exigency and the Postal Service’s public clamor regarding its fiscal position, the Postal Service’s response to Order No. 1059 was utter silence. More than 2 ½ years passed before the Postal Service filed even a single new document in the exigency case docket.⁴⁶

But the Postal Service repeatedly took steps to increase revenue during those 2 ½ years. In particular, since November 2011 it raised market-dominant rates twice: January 2012 and January 2013. A third increase, conditionally approved last week by the Commission, is scheduled to take effect on January 26, 2014. In addition, the Postal Service has also raised its rates for Competitive products several times.

And, of course, the Postal Service has also taken steps towards reining in its costs. Throughout that time, the Postal Service seemingly had abandoned any effort to pursue an exigent increase. No postal official discussed it; no status filings were made. Indeed, the Postal Service never responded to Order No. 1059 until September 2013, if the filing in this case can be described as a “response” to that Order. In the meantime, mailers made plans, signed contracts, and invested money in reliance upon the established pattern of index price increases.

And, under the Postal Service’s theory, the volume losses purportedly “due to” the recession have grown steadily during this inaction. Indeed, the volume losses that

⁴⁵ *Order Addressing Motion To Supplement and Related Filing* at 8 (Dec. 20, 2011) (Order No. 1059).

⁴⁶ Nor has the Postal Service ever sought an exigent adjustment to offset any losses that it may have incurred from natural disasters, such as Hurricane Sandy.

the Postal Service contends it suffered in FY2012 due to the recession were the largest volume losses in any year. By sitting on its right to seek exigent rates, the Postal Service has allowed, under its own theory, the problem to get worse.

For that reason, the Postal Service should be held barred by the doctrine of laches from relying on any volume losses after, at the latest, September 2010 in seeking an exigent rate increase. The doctrine of laches applies to the government when it operates in a commercial capacity. See *United States v. Administrative Enterprises, Inc.*, 46 F.3d 670, 673 (7th Cir. 1995) (allowing laches in cases where the government seeks to enforce its own “private” rights, relying on *Clearfield Trust Co. v. United States*, 318 U.S. 363 (1943)).⁴⁷ And the related doctrine of equitable estoppel has been invoked against the Postal Service in a commercial dispute. *Portman v. United States*, 674 F.2d 1155 (7th Cir. 1982),

Application of the equitable doctrine of laches is appropriate where: (1) the Postal Service acted unreasonably in delaying its pursuit of an increase and (2) the delay caused harm to the adverse party. Here, there is no dispute that the Postal Service delayed its pursuit of a rate increase – even seeking a stay and, after not receiving one, essentially granting itself one – and, if its claims of ever-growing volume losses are to be credited, that it was unreasonable for it to do so and let its finances deteriorate still further.

⁴⁷ See also *New York v. Pataki*, 413 F.3d 266 (2d Cir. 2005) (following the Seventh Circuit’s approach in *Administrative Enterprises* and subjecting the United States to the defense of laches); *accord Securities and Exchange Commission v. Sprecher*, 1993 WL 544306, *2 (D.D.C. 1993) (“[T]he government is not subject to the defense of laches *when acting in a nonproprietary capacity*.”); *F.D.I.C. v. Knostman*, 966 F.2d 1133, 1139 (7th Cir.1992); *United States v. Philip Morris, Inc.*, 300 F. Supp. 2d 61, 73-74 (D.D.C. 2004) (“it is correct that the United States is subject to laches in certain restricted contexts, such as commercial suits”).

Second, through its inaction, the Postal Service has injured mailers that have made substantial investments in mailing hardware and software in reliance on the Postal Service's practice of seeking only index adjustments since 2011. Just last year, the Postal Service's Inspector General recognized that many businesses were "questioning whether or not it is worth investing in new First-Class Mail mailing equipment with a 5- to 10-year life span." Office of Inspector General, *Summary of Focus Group Discussions on the Future of First-Class Mail: Management Advisory* at 14 (April 20, 2012). Mailers that made such investments were not counting on an exigent rate increase, as postal management said nothing about one for several years. Recently, many mailers have made substantial investments to implement Full-Service Intelligent Mail barcode. Had the Postal Service sought exigent rates in a more timely manner, the analysis as to whether to make that investment could have been significantly different, and the mailers may have made different decisions. One such alternative decision might have been to forego the investment and instead re-double efforts to migrate customers to electronic presentment at an even faster rate.

Consequently, the Postal Service's seeming abandonment of its exigent request for nearly two years has harmed mailers by: (1) giving the Postal Service an opportunity to inflate the contribution allegedly lost "due to" the recession by including later years in its calculation (and thus potentially creating a permanent circumvention of the cap); and (2) inducing mailers into making investments in mailing that they might well not have made. For these reasons, the Commission should hold that the Postal Service's request for exigent rate increases is barred by laches, and that its attempt to base such a request on losses occurring after September 2010 is likewise barred.

III. THE POSTAL SERVICE'S REQUESTED EXIGENT PRICE INCREASES ARE NOT REASONABLE AND EQUITABLE AND NECESSARY OR CONSISTENT WITH BEST PRACTICES OF HONEST, EFFICIENT AND ECONOMICAL MANAGEMENT

In order to be allowed above-cap rate increases under the narrow statutory exigency exception, not only must the Postal Service prove the existence of an “extraordinary or exceptional circumstance,” but it must also show that the requested rates are:

reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.

Section 3622(d)(1)(E). This case is one of first impression; the Commission has not previously interpreted or applied this provision.

For the Commission to approve the 4.3 percent increase for First-Class Mail, it must determine that raising rates by triple the inflation rate for the most profitable, yet declining, product is reasonable, equitable, and a best practice by good management. The Joint Commenters submit that it would not be, because: (1) it would accelerate diversion still more; and (2) the size of the increase exceeds what reasonably can be predicted by its existing estimates of price elasticity of demand, and the Buc Declaration explains that the demand for mail is more elastic than the Postal Service believes. Furthermore, an increase of 4.3 percent would not be equitable due to the Postal Service's own inactions discussed above under the doctrine of laches.

Good management does not raise prices to a counter-productive degree, driving away its customers at accelerating rates. Nor does good management raise prices an average of a cumulative 6 percent, when inflation is but 1.6 percent, without fully

understanding how its customers will respond to the higher prices. The Joint Commenters believe, based on their knowledge of the industry, that if the requested rates were to take effect, the Postal Service would experience a far greater loss of volume than it appears to expect, likely resulting in a net loss of revenue but inevitably leading to even more dramatic volume declines – and perhaps future exigency cases -- in the future.

As such, the rates requested by the Postal Service can hardly satisfy the statutory requirement that they be “reasonable and equitable and necessary under best practices.” If the Commission sets exigent rates, it should set them substantially below the levels requested by the Postal Service, and set the pass-throughs of worksharing discount to 100 percent where such could be done without increasing rate shock on other mailers.

A. A 4.3 Percent Increase, On Top Of The Approved 1.67 Percent Indexed Increase, Would Accelerate Electronic Diversion Of The Postal Service’s Most Profitable Products

The Section 3622 factors apply to proposed exigent prices as well as to indexed rate adjustments. The Commission must consider “the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters” (39 U.S.C. §3622(c)(3)) and the relative value of the mail service actually provided to senders and recipients (39 U.S.C. §3622(c)(8)), all within a system that establishes and maintains a “just and reasonable schedule for rates and classifications” (39 U.S.C. §3622(b)(8)).

The cumulative 6 percent price increase (including the recently approved index adjustments) requested for the First-Class Presort Letters and Postcards product would

cast doubt on the justness and reasonableness of the rate schedule. That product is, and for many years has been, the most profitable mail for the Postal Service, bearing a cost coverage of 293.3 in the most recent Annual Compliance Determination (*Annual Compliance Determination Fiscal Year 2012* at 81) and a coverage of 313.1 in FY2013. *Nickerson Statement*, Attachment 9. Not only is this mail highly profitable on a unit basis, but it also is the product that provides the single largest source of contribution to institutional costs, more than \$10 billion in FY2012. *ACD FY12* at 81.

As customers get more and more comfortable with conducting financial and account-related transactions electronically, First-Class Presort letter volumes continue to come under increasing pressure. *See generally Buc Declaration* at 22-25. Companies understand that electronic presentment is less costly and more convenient. Electronic communication is faster, can reach consumers wherever they are (rather than at a fixed address), is much less costly, and is increasingly attractive. As more accounts are created online or enrollments managed electronically, companies are able to satisfy the disclosure and consent requirements under the federal E-SIGN (or state-level Uniform Electronic Transaction Act) requirements. And, as noted above, a growing number of states have begun to relax regulatory restrictions that formerly required businesses to communicate with their customers via hardcopy mail.

All of these communications previously would have been required to travel in the mail. None of them are shifting to electronic because of the recession; they are shifting due to convenience, lower cost, and consumer acceptance.⁴⁸ Over the past decade,

⁴⁸ A February 6, 2011, eBilling Benchmarking Study published by NACHA, the Electronic Payments Association, reported that as of then: (1) more than 25 percent of all bills were sent electronically (2) cost-savings of up to 40 to 50 cents per bill was a major driver; and (3) that ebilling customers were happier and easier to retain. It also anticipated that ebills would exceed paper bills by 2016.

the cost of postage has come to comprise a much greater share of the cost of a mailing than previously. Where in years past the rule of thumb was that paper, printing, and postage would each comprise about one-third the cost of a mailing, those days are gone. Mailers report that postage now comprises nearly 75 percent of the cost of mailing. *Buc Declaration* at 17.

Large mailers are responding to this change by taking a sharper pen to mailing budgets. Indeed, some very important mailers indicate that even the requested increases in this case have attracted unprecedented attention in their executive offices. *Id.* at 18. And postage increases that exceed inflation are literally counterproductive -- the higher postage costs actually create the financial incentive (and, in effect, the funding) for mailers to invest more aggressively in encouraging their customers to convert to electronic. *Id.*⁴⁹ As large users of the First-Class Automation and Presort letters continue their efforts to entice more customers to accept electronic presentment, and to engage in electronic payment, rather than use letter mail, a cumulative 6 percent increase could easily accelerate still more diversion from the mailstream.

The Postal Service acknowledges this fact: “Most commercial customers are actively seeking cost reductions that may result in decisions to adopt electronic and other mail alternatives.” *Statement of Altaf Taufique* at 31. It also says that rates that are “too high” could threaten the financial health and, possibly, even the survival of key customer segments and industries.” *Id.* at 2. But the true danger here is not the demise

https://www.nacha.org/userfiles/File/Council_for_Electronic_Billing/Resources/eBill%20Benchmarking%20Study/eBill%20Benchmarking%20CEBP%20presentation.pdf.

⁴⁹ If postage increases “bust the cap,” mailers are likely to experiment more with “mail surcharges” for some customers or condition low-value relationships (small balance bank accounts) on electronic communication. *Buc Declaration* at 18.

of postal customers – banks, insurance companies, and telecommunications services providers will remain in business after this case. Instead, the danger is that they might not use the mail nearly as much as the Postal Service assumes.

The Postal Service talks the talk. It says that it “is concerned that the accelerated electronic diversion caused by this recession could be exacerbated by an increase larger than the one proposed in this docket.” *Id.* at 10.⁵⁰ But it does not walk the walk, as it offers no support or explanation for saying that “[a] reasonable overall increase of 6 percent . . . will help keep customers in the mail.” *Id.* at 11. The unsupported judgment of the person proposing the price increases is not reassuring.

The Postal Service provides *no* analysis of the mailing market that would support the proposition that increases averaging 4.3 percent or more above CPI, and cumulatively approaching 6 percent, would keep customers in the mail. Indeed, it concedes that the across-the-board 4.3 percent requested in this docket was selected without any real assessment of its effect on mailers. *Response to POIR No. 5*, Q8. Put simply, it is a Goldilocks amount, deemed to be not too high and not too low. There is no evidence of any effort to assess the consequences of such an increase other than to apply the price elasticities of demand found in the forecasting models. But there is little reason to think that those, particularly for First-Class Mail, are incorrect.

⁵⁰ This is reminiscent of similar statements in Docket No. R2010-4 in which Postal Service representatives acknowledged limitations in how their model treated the Internet. For example, witness Kiefer stated: “Large customers affect large volumes of mail, and if prices increase too much, these customers may decide not just to scale back their mailings, but to leave the mail altogether. Current econometric estimates of price elasticity may not adequately predict such “tipping point” movements.” *Statement of James M. Kiefer* at 13 (emphasis added).

Indeed, it is distressing that the Postal Service is asking for a total increase of 6 percent – roughly three times the rate of inflation -- without doing more to ascertain how its customers would respond. Imposing such a rate increase without solid market analysis or, as discussed in the next section, without a reliable estimate of price elasticity of demand, is not a best – or even reasonable -- practice of honest, efficient, and economical management. Accordingly, the request should be denied. If the Commission approves any exigent rate increase, it should not increase the prices charged First-Class Presort Letters, which are already the most overpriced product in the system and highly vulnerable to increased diversion.

B. The Price Elasticity Of First-Class Mail Is Likely Much Higher Than The Postal Service Assumes

The Joint Commenters have long been concerned that the Postal Service's estimates of price elasticity of demand do not inaccurately account for the effects of electronic migration. SLS was asked to assess the validity of current postal estimates of the price elasticity of demand for First-Class and Standard Regular mail, products used by members of the associations submitting these comments. That analysis, filed concurrently in the Buc Declaration, provides both analytical and empirical evidence that the real world demand for First-Class mail is far more elastic than the Postal Service believes.

SLS identified two reasons to doubt the accuracy of the Postal Service's estimated price elasticities of demand for First-Class and Standard Regular mail:

- Because real prices have changed very little over the past six years, the Postal Service's price-elasticity estimates over that time do not provide useful insights of how volume would change in response to larger real price changes. This is especially true in the case of the on-average 4.3 percent increases in this exigency case, which combined with the rates in Docket No.

R2010-10 would result in price changes of about 6 percent, or roughly *four times* the rate of inflation.

- Surveys and interviews with mailers indicate that the true demand elasticities are far more elastic than the Postal Service believes.

To the first point, the Buc Declaration explains that the real prices of First-Class and Standard Mail have changed little since enactment of the PAEA. *Buc Declaration* at 10. This is unsurprising; indeed, it is the intended result of the inflation-based cap regulatory regime that Congress enacted. As a result, the Postal Service's demand model shows that price elasticity has shown comparatively little effect of price on volume, which is entirely consistent with little real price change having occurred.

However, an important implication of that fact is that, since real prices have barely changed over the last six years, estimates of price elasticity of demand over that same period have little predictive value, as a matter of econometrics, when prices are changed by more than inflation. This is particularly true in the case of the 300 percent increase over the rate of inflation requested in this case. *See Buc Declaration* at 3 & 10.

Nor is it likely that estimates that predate 2008 would provide relevant data. As the Postal Service itself notes, the market in which it operates today differs greatly from that of 2006 or earlier years. The rapid improvements in alternative means of communication since 2006 or 2007 render suspect any econometric estimate of price-elasticity that relies on pre-2008 data. And, contrary to the Postal Service,⁵¹ the lack of real price change in recent years makes it unlikely that the effects of postal prices on

⁵¹ *Response to POIR No. 2, Q4 (Thress)* (stating that to extent postal prices affect diversion, that effect is implicit within the own-price elasticity estimates).

the level of Internet diversion would be accurately accounted for by the Postal Service model.

In contrast to the Postal Service's econometric models, SLS conducted surveys and interviews with mailers to assess whether the Postal Service's elasticity estimates appear reasonable. As indicated by the Buc Declaration, they do not. Based on the SLS survey, there is reason to believe that the actual price elasticity of First-Class Presort Mail is much higher than that used by the Postal Service. *Buc Declaration* at 16-19. If real First-Class price elasticities of demand (Presort or Single-Piece used by large businesses) are higher than the stale elasticities used by the Postal Service, a rate increase of the magnitude proposed here would drive away significantly more volume than anticipated, which would aggravate the Postal Service's financial condition. There is also a suggestion that at least some Standard Regular mail -- used by many large First-Class mailers as well -- may have an elasticity that exceeds -1.0. *Buc Declaration* at 14-16.

In the case of First-Class Mail, the Postal Service calculates that with a January 26, 2014, implementation of the cumulative 6 percent average price increase, it would lose about 500,000,000 pieces of First-Class Mail in FY2014. *Nickerson Statement*, Attachment at 24-25. The Postal Service's calculation is based on its flawed assumption regarding electronic diversion discussed above and its underestimation of the price elasticity of demand for First-Class Mail. Consequently, the actual volume loss in FY2014 alone would likely significantly exceed the losses anticipated by Mr. Nickerson, and would extend inevitably into future years as well as higher prices drive mailers simply to redouble their efforts to convert customers to electronic servicing.

C. If The Commission Approves Any Exigent Price Adjustments, It Should Passthrough Full Cost Savings From Worksharing In First-Class Presort Letters

At a time when the Postal Service is under enormous pressure to reduce its costs, it should be giving as much encouragement to mailers to engage in cost saving activity. Worksharing is an important and well-recognized means of doing so. The Postal Service should be encouraging mailers of Presort letters to maximize the use of worksharing in order to reduce both postal and overall costs, which would also have the salutary effect of encouraging mail volume retention and growth.

Unfortunately, the Postal Service has failed to do so, and the 2013 rate filings have accentuated this problem. In the Docket No. R2013-10 index case, the Postal Service chose to pass through only 81 percent of the costs avoided by 5-Digit Presort letters. Docket No. R2013-10, USPS-LR-R2013-10/1 - First-Class Mail Workpapers CAPCAL-FCM-R2013-10.xls, Tab "Cost Avoidances"). This miserly pass-through is a missed opportunity to provide more accurate pricing signals as the Postal Service has chosen to eliminate a separate rate for the 3-Digit presort tier. As the Joint Commenters stated in their comments in that proceeding, in so doing the Postal Service missed an opportunity to reduce the price charged its largest and most important category of mail, and increase its competitiveness to alternatives to the mail.

This case gives the Commission an opportunity to correct the Postal Service's inefficient 5-Digit discount pass-through. The requested rates would passthrough only 89.3 percent of the costs avoided by First-Class Automation 5-Digit letters, the most profitable product in the system. *Taufique Statement*, Appendix A, Page 2. The Postal Service requests to passthrough only 31.7 percent of the costs avoided by

Nonautomation Presort letters compared to their benchmark. *Id.* If the Commission adjusts rates, it should correct these inefficient pass-throughs.

IV. CONCLUSION

For the foregoing reasons, the National Postal Policy Council, the Major Mailers Association, the National Association of Presort Mailers, and the Association for Mail Electronic Enhancement respectfully urge the Commission to reject the requested exigent rate increases for First-Class mail.

Respectfully submitted,

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